Nos. [redacted]

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Eddy D. Field and Helen Field,

Petitioners,

vs.

Commissioner of Internal Revenue,

Respondent.

BRIEF FOR PETITIONERS.

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BRIEF FOR PETITIONERS.

Jurisdiction.

This petition for review involves deficiencies in Federal income and Victory taxes for the year 1943 in the amount of $7,913.65 as to petitioner Eddy D. Field, and $8,083.13 as to petitioner Helen Field. The cases of the two petitioners involve identical issues and were consolidated for hearing before the Tax Court of the United States, hereinafter referred to as "Tax Court." The decisions of the Tax Court determining said deficiencies were entered May 4, 1949 [Tr. pp. 37-38]. This Petition for Review was filed July 1, 1949, pursuant to the provisions of Sections 1141 and 1142 of the Internal Code, 26 U. S. C. A., Sections 1141 and 1142.

Opinion Below.

The only previous opinion rendered in this cause is the memorandum opinion of the Tax Court [Tr. pp. 27-37]. This opinion was not reviewed by the Tax Court.

Questions Presented.

The sole question presented for decision is whether the profits realized by petitioners on the sales in 1942 of two pieces of improved real estate and the profits on the sales in 1943 of eight pieces of improved real estate, each held by them for more than six months for investment and rental income, are taxable as ordinary income or as capital gain.

Statutes and Regulations Involved.

Internal Revenue Code (26 U. S. C. A.):

"Sec. 117, Capital Gains and Losses.

(a) Definitions—as used in this Chapter.

(1) Capital Assets. The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), * * * or real property used in the trade or business of the taxpayer.

(j) Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.

(1) Definition of property used in the trade or business. For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) General Rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat of imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

REGULATIONS 111

Sec. 29.117-1. Meaning of terms.—The term 'capital assets' includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a 'capital asset,' the period for which held is immaterial.

The exclusion from the term 'capital assets' of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23(1) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117(b) and losses from such transactions are not subject to the limitations on losses provided in section 117(d), except that under section 117(j) the gains and losses from the sale or exchange of such property, held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See section 29,117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term 'capital assets,' even though depreciation may have been allowed with respect to such property under sections 23(1) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117(b), (c), and (d). The term 'ordinary net income' as used in these regu-

lations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

Sec. 29,117-7. Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.— Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23(1), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business. * * * shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets."

Statement of Facts.

This proceeding was submitted to the Tax Court on the pleadings, oral testimony offered by the petitioners and exhibits introduced in evidence of the hearing.

The respondent introduced no evidence. The facts here involved may be summarized as follows:

1. Petitioner Eddy D. Field became a real estate salesman in Los Angeles in 1926. In 1927 he obtained a real estate broker's license and has been engaged in business as a real estate and insurance broker since that time [Tr. p. 45]. He started with no money. He married petitioner Helen Field in 1929. Mrs. Field has never been connected with his brokerage or insurance business [Tr. p. 45]. He started in this business with two associates in 1927; in 1934 petitioner bought out his associates and has since that date owned and operated the brokerage and insurance business on his own account [Tr. p. 46].

2. As a broker he represents buyers and sellers of real estate on a commission basis. He has never represented himself to be anything but a real estate and insurance broker [Tr. p. 47].

3. In 1934 petitioner and his wife organized a corporation known as Oxford Associates paying in $2,000 for the stock of this company which they owned equally. This company was organized by them to purchase rental income properties as investments [Tr. pp. 47-48]. At that time petitioner had limited means and had to purchase small properties such as duplexes or 4-unit apartments which could be purchased for small down payments of from $500 to $1500 and the balance secured by mortgage. Oxford Associates bought any small property that it could afford which would return a rental income [Tr. p. 48].

4. Between 1934 and 1941 this corporation acquired nineteen pieces of such property [Tr. p. 49]. One or two properties were sold by the Corporation during those years but most were held as income producing units. On December 31, 1941, the corporation was dissolved and the properties were distributed to petitioners [Tr. p. 49]. They still own twelve of the nineteen properties distributed to them [Tr. p. 49].

5. In 1942 petitioner Eddy D. Field sold for others as a broker 148 pieces of property on which he received total commissions of $52,000.00, and in 1943 he sold as a broker for others 155 pieces of property, receiving total commissions of $71,000 [Respondent's Exhibits "C," "D," "E" and "F"]. In 1942 petitioners received as rental income from investment properties $11,287 and in 1943 received rental income of $16,958 [see same Exhibits].

6. The tax returns filed by petitioners for 1942 and 1943 [Respondent's Exhibits "C," "D," "E" and "F"] show date of acquisition of the properties involved in this proceeding, the cost and selling price and date of sales. It was stipulated that the facts shown on these returns with respect to such matters are correct [Tr. p. 44]. The properties which are shown on the returns as acquired by petitioner January 1, 1942, are the properties petitioner received from Oxford Associates on liquidation on that date. These properties were all acquired by petitioners' corporation between 1934 and 1941.

7. In January, 1942, petitioner Helen Field sold a residence at 1500 South Hauser. She acquired a half interest in the property in 1936 and purchased the remaining one-half interest in 1939. The profit on this sale was reported as long term capital gain by petitioners on com-

munity property basis. However, this was in error because the property is the separate property of petitioner Helen Field and not community property. Her mother and sister lived in this property and it was sold because the doctor had advised petitioner's mother she should move out of that locality.

8. Petitioners sold two properties in 1942, Longwood in March and Roxbury in July. Although Longwood had been acquired by Oxford Associates several years before, the profit on this sale was reported as short term gain because it was sold by petitioners within six months from the date it was distributed to them by the Corporation. The method of reporting the profit on this sale is not in controversy. Roxbury was a four-unit apartment acquired by Oxford Associates in 1938, with a down payment of $1500. It produced a rental income. It was sold in 1942 to apply on the purchase price of an 8-unit apartment on Commodore Sloat Drive.

9. In 1943 petitioners sold eight pieces of improved real estate held by them for more than six months and purchased for investment and rental income and reported in their tax returns as long term capital gain the profit from their sale. These properties are known as LaJolla, Vineyard, Kenmore, Commodore Sloat Drive, Croft, High-Point, Beechwood, Clark. The petitioners sold the first four of these properties, namely LaJolla, Vineyard, Kenmore and Commodore Sloat, in order to purchase a 5-story, 75-unit apartment house known as Cherokee. The Cherokee property was purchased in July, 1943, for $176,-000 and required a down-payment of $35,000 and an additional $1500 for taxes and escrow expenses. This apartment building is still owned by petitioners although they

have received offers to sell it for $450,000 [Tr. p. 53]. The original mortgage of $140,000 had been reduced at the time of trial to approximately $50,000 [Tr. p. 53]. Petitioners received monthly rentals of approximately $1900 from the properties sold to finance the Cherokee purchase, whereas the rental of Cherokee Apartments is in excess of $4600.00 monthly.

10. The LaJolla property was acquired by the Corporation in 1938. A bowling alley and liquor store had been built next to it and it became undesirable rental property.

11. The Vineyard property was acquired by the Corporation in 1936. The Kenmore property had been acquired in 1943. The Commodore Sloat was acquired in 1943. Croft was a duplex purchased by petitioners' corporation in 1935 and was sold in 1943 to purchase a 12-unit apartment on Orange. The Clark property was a 4-unit apartment acquired in 1946; in 1943 rents on it were frozen and petitioner sold it to buy two double bungalows on corner lot which they considered a better investment. High-Point was a house acquired in 1936 by petitioners' corporation which became vacant and rents were frozen at $60 per month. It and the Beechwood property were sold in 1943 to acquire an interest in a six-story apartment building on Gramercy Street.

12. All of the properties acquired prior to 1942 by petitioners' corporation were small units bought for rental income and were purchased on small down payments, ranging from $500 in the case of Croft, and $1500 in the case of Roxbury.

13. Petitioner never used any of the money received by him from any of these sales in his brokerage and insurance business but rather took money from that business

to acquire his rental properties [Tr. p. 57]. The monies received from the sales of these properties were either invested in better rental property or used to pay off existing trust deeds on properties which petitioners owned, thereby increasing their equity [Tr. p. 57]. Petitioner testified that the properties sold in 1943 were never held primarily for sale but were held primarily as investments and for rental income [Tr. p. 58]. Petitioner Eddy Field had three real estate brokerage and insurance offices. Neither he nor any of his employees in the brokerage offices devoted any time to the management of his investment properties [Tr. p. 58].

14. Petitioners have still retained good properties purchased many years ago. For example, they still own a 2-store and 6-apartment unit at 338 North La Brea acquired in 1936, which is a good rental property [Tr. p. 58]. Also in 1938 they acquired a 4-story brick 45-unit apartment known as the Baker Apartment. Petitioners have had numerous offers to sell that property and have turned down as much as $135,000 for it. They have refused to sell because it is the type of property they want to keep because it shows a good rental income, is a sound investment and is in a good location [Tr. p. 59].

15. Petitioners started to make real estate investments in small properties because that was all they could afford, but their objective was to acquire properties with large units. It was their idea as they could afford larger units they would dispose of the smaller ones with which to make the purchases. Their earnings were used to buy small places until they found and could afford large units such as the Cherokee, and when they found such opportunities they sold the small ones and bought the large ones. The large units they still own.

Specifications of Error.

(1) The Tax Court erred in holding that the two real properties sold by petitioners in 1942 and the eight real properties sold by them in 1943, which properties they had held for more than six months as investments and for rental income, were sales of properties held primarily for sale to customers in the ordinary course of their trade or business of buying and selling rental properties.

(2) The Tax Court erred in refusing to hold that petitioners held said ten parcels of real estate for investment and rental income and in failing to hold that petitioners were, therefore, entitled to the benefits of Section 117(a) and Section 117(j) of the Internal Revenue Code.

Summary of Argument.

(1) The sole point of disagreement is whether the profit on the sale of the ten parcels of real estate referred to are taxable at capital gain rates or as ordinary income. This depends upon the intent of petitioners in acquiring and selling said eight parcels.

(2) The finding that the properties in question were held primarily for sale to customers in the ordinary course of petitioner's trade or business finds no support in the evidence.

(3) The Tax Court's Conclusion of Law is inconsistent with its Findings of Fact because the Findings properly made compel the conclusion that the properties in question were capital assets.

(4) Should this Court be of the opinion that the Tax Court drew the ultimate inference which supports its decision, it nevertheless remains free to draw its ultimate inferences and conclusions which in its opinion the Findings of the Tax Court reasonably induce.

ARGUMENT.

I.

The Sole Question Is Whether the Two Parcels Sold in 1942 and the Eight Parcels Sold in 1943 of Improved Real Estate Were Assets of a Kind Entitled to the Benefit of Section 117 of the Internal Revenue Code.

There is no question raised as to the cost, selling price, holding period, or profit on the sales of these properties. It was stipulated that these facts are clearly shown on petitioners' Tax Returns, Exhibits "C," "D," "E" and "F." The properties involved are set forth in the Tax Court's Findings as the long term capital gain reported by petitioners in their 1942 and 1943 Tax Returns. In addition the Tax Court found that petitioners in 1943 sold seven pieces of real estate held for less than six months, the dates of acquisition and sale being set forth in the Findings.

The Tax Court's opinion begins by starting as follows:

> "Specifically the question herein is whether the properties sold by petitioners in 1942 and 1943 were capital assets within the meaning of Section 117(a) (1) of the Internal Revenue Code, or were 'properties held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business'."

It is respectfully submitted that that is not the question in this case. The sole question is whether the two properties sold in 1942 and the eight sold in 1943 and held for more than six months, are entitled to the benefit of Section 117 of the Internal Revenue Code and the profit on their sale therefore taxable as "capital gains." We are not at all concerned with whether or not other properties

owned and sold by petitioners in 1943 were or were not entitled to the benefits of that section. We are concerned only with the properties which we reported for tax purposes as capital gains.

If the properties in question were held as investments and for rental income they are capital assets as defined in Section 117(a) of the Code; if it be held that petitioners were engaged in the business of holding rental properties for the production of rental income the profit on their sale is taxable as capital assets under Section 117(j) of the Code. The deficiency letter by which respondent determined the deficiencies in question states:

> "The properties sold in 1942 and 1943 from which you reported net capital gains in the amount of $3,607.19 and $29,239.73 respectively, are not capital assets within the meaning of Section 117(a)(1) of the Internal Revenue Code, and the gains from the exchange or sale of the properties reported in 1942 and 1943 are fully taxable as business income. * * *"

It will be noted that the Commissioner's determination was based solely upon the ground that in his opinion these assets were not capital assets within the meaning of Section 117(a)(1). He made no determination as to whether or not the holding of these properties was of such a character as to be entitled to the remedial provision of Section 117(j) of the Code. It is the petitioner's contention that the properties in question were capital assets within the meaning of Section 117(a) but that in any event they were properties entitled to the benefits of Section 117(j). This depends upon the intent of petitioners in acquiring and holding said real estate.

II.

There Is No Evidence to Support the Tax Court's Finding That the Two Properties Sold in 1942 and the Eight Parcels Sold in 1943 Were Properties Held Primarily for Sale to Customers in the Ordinary Course of TheirTrade or Business of Buying or Selling Real Estate for Profit.

Petitioner Eddy D. Field was the only witness who testified. His testimony shows that he has been a real estate broker in Los Angeles since 1927 earning his living by commissions earned on the sale of properties belonging to others; that when he started he had no financial resources; that he started business with two associates but finally in 1934 had acquired the interest in the brokerage business of the other two partners and since said date has operated his brokerage and insurance business himself; as a broker he listed for sale properties of other persons, advertised such properties, put signs upon them, and employed salesmen to sell them [Tr. p. 11]. In 1934 he and his wife organized a company known as Oxford Associates, in which they owned equally all of the stock. They organized this company for the purpose of purchasing rental income properties as investments. Their resources were limited and they started by purchasing small properties, duplexes of three or four units, requiring down payments of from $500 to $1,000. Petitioners paid into the corporation $2,000 for their stock and the title to rental properties purchased were taken in the name of the corporation [Tr. pp. 12-13]. These properties were purchased with a small down payment and a mortgage given for the balance of the purchase price. The corporation acquired between its organization in 1934 and its dissolution December 31, 1941, nineteen properties. On this latter date

the corporation was dissolved and the properties distributed to petitioners in exchange for their stock. Of those nineteen properties so acquired by the corporation petitioners still own twelve.

In 1942, petitioner Helen Field sold a residence property on South Hauser which was her separate property and which she acquired in 1936, because her mother and sister were living there. On doctor's instruction, the mother was advised to seek a new location. Although petitioners reported this as community property, it is obvious that that was an error on their part. The property was the separate property of petitioner Helen Field and the profit is taxable to her. Petitioner Helen Field had never been in any business and the sale of that one property by her is clearly the sale of a capital asset.

Two other properties were sold by petitioners in 1942—Longwood and Roxbury. No evidence was offered with respect to reasons for the sale of Longwood as its profit was reported as short term gain because it was sold less than six months after January 1, 1942, the date petitioners acquired it on liquidation of Oxford Associates. The other property, Roxbury, was a 4-unit rental property acquired in 1938. It was sold in 1942 to purchase an 8-unit rental property.

The foregoing states absolutely all the evidence with respect to the sales in 1942, and yet the Tax Court held that the evidence showed that these properties were held primarily for sales to customers in the ordinary course of their trade or business of buying and selling real estate for profit. It is an almost incredible finding, but shows a lack of consideration given the undisputed facts by the Tax Court.

Petitioners sold eight rental properties in 1943. The only evidence in the record as to why these eight properties were purchased and sold is the uncontradicted evidence of petitioner Eddy Field. Six of the 8 properties had been acquired by the petitioner's corporation between 1935 and 1941. He testified they had all been purchased for investment and rental income and had been bought because they were purchased with small down payments and the balance on mortgages. He testified that it was his hope, as his financial resources permitted, to invest in larger rental units. Four of these properties were sold in 1943 to raise money with which to purchase a 5-story 75-unit apartment house building known as CHEROKEE, a rental property that produced $4600 a month rent as opposed to $1900 a month return by the rental properties he sold in order to buy it. Petitioners still own CHEROKEE in spite of opportunities to resell it at a tremendous profit and petitioners have decreased the mortgage from $140,000 at the time of purchase, to approximately $50,000 at the time of trial. This, we submit, is evidence of the fact that petitioner was trying to consolidate his equities in larger rental properties rather than holding smaller ones. Two other properties in question were sold to purchase an interest in a 6-story apartment building known as GRAMERCY. Of the two other properties sold, one was sold to buy a double bungalow considered a better investment, and the other was sold because it became vacant and rents were frozen. In each instance, the monies which petitioner realized from the sale of these rental

properties was used to purchase larger rental properties which produced a larger rental income.

Petitioner further testified that no one in his employ had anything to do with the sale of these properties, that they were not advertised for sale or listed by his brokerage office for sale and that they were separately set up in the books of account as his personal investments.

There is not one bit of evidence in the record to support the finding that Petitioner sold any of these properties to realize a profit. The evidence is he sold them to raise cash to buy larger rental properties which he considered more desirable investments.

The Tax Court's findings relate to intent. It is submitted that the Court had no alternative on the uncontradicted evidence but to find that petitioners' intent was to hold these properties for investment and rental income. See *Foran v. Commissioner,* 165 F. 2d 705. The question in that case was the intent of the taxpayer in respect to certain property, whether he intended to hold it for investment or for sale. The taxpayer's testimony as to his intent was the only evidence before the Court but the Tax Court held the properties were held for sale by the taxpayers. In reviewing the Tax Court's opinion the Court of Appeals distinguished *Greene v. Commissioner,* 141 F. 2d 645, and said:

> "The distinction between that case and this is found in the majority opinion in these words:
>
> " 'There was no direct proof of intent or purpose even in the testimony of Mr. Greene (taxpayer) and

the Tax Court was required to draw an inference as to this ultimate fact from the circumstantial evidence relative thereto.' Here there is direct and positive evidence from the witness who best knows that this property was for 17 months being held as an investment and not held for sale to customers. His testimony is consistent with every proven fact. He gives a credible reason why it was not for sale and why finally in 1941 he did sell it. We think the Court's refusal to follow the sworn testimony is contrary to law, and requires the setting aside of its fact-finding as it would that of a jury. We quote from *Penn. Railroad Co. v. Chamberlain,* 288 U. S. 333, page 340, 53 Supreme Court, 391, 394, 77 L. Ed. 819, 'And the desired inference is precluded for the further reason that respondent's right of recovery depends upon the existence of a particular fact which must be inferred from proven facts, and this is not permissible in the face of the positive and otherwise uncontradicted testimony of unimpeached witnesses consistent with the facts actually proved, from which testimony it affirmatively appears that the fact sought to be inferred did not exist. This conclusion results from a consideration of many decisions, of which the following are examples (citing cases): A rebuttable inference of fact * * * "must necessarily yield to credible evidence of the actual occurrence."' We recognize that intent may be proved by circumstances, and that a party's testimony as to his intent may be rebutted by proof of circumstances which are inconsistent therewith. We hold that no circum-

> stances found by the Tax Court here is inconsistent with the reasonable and uncontradicted testimony of Foran."

That is the identical situation we have here. Petitioner testified that he had held these properties as investments and for rental income; that four of them were sold in 1943 to raise money to purchase the 75-unit apartment which was producing almost two and one-half times as much monthly rental income. One was sold because it was vacant and rents frozen and the neighborhod had become undesirable. Two were sold to purchase more desirable income producing property—an interest in a 6-story apartment known as GRAMERCY.

Shortly after the decision in the case at Bar the Tax Court in a decision reviewed by the entire court, passed on what a security dealer must do to realize capital gain from a sale of securities of the same kind as those in which he deals. In the case of *Van Tuyl,* T. C. 119, the taxpayer's firm was an "over-the-counter" house specializing in defaulting railroad securities. During 1942, 1943, and 1944, the firm made many purchases and sales of two such issues. All transactions were entered on its books in regular trading accounts. In October 1942, believing that the bonds were good for a long pull, the firm purchased a $35,000 block which it requested its bank to segregate and not deliver out of its account until further notice. The Bank acknowledged the advice, setting forth the number of the bonds so segregated. It placed the bonds in a

separate envelope and notified its security clerk to keep it separate from other bonds held as collateral for the firm's loans. On the firm's books the purchase was first entered in the regular trading account but at the end of the month it was transferred to a special account separate from the regular trading ledger. After closing out the regular account for October 1942, the firm discovered that due to an error, the account was short $10,000 par value of the bonds in question. In November, to cover the shortage, it requested the Bank to release $10,000 of the frozen bonds, which was done. Shortly thereafter the firm purchased additional blocks of the same bonds and replaced those which it had withdrawn from the frozen account. In 1944 the frozen bonds were sold at a profit.

The Commissioner treated the profit as ordinary income, arguing that the bonds were originally acquired as inventory items and that a mere intention to switch them to investments did not convert the profit into capital gain. The Court held that that argument did not apply to the facts here. These securities were acquired as investments and consistently held as such. It was held immaterial that some of them were immediately released and treated as inventory items, since the taxpayer showed that this was done merely to correct an error.

Shortly after this case the Tax Court decided the case of *Carl Marks & Co., Inc.*, 12 T. C. 161. In that case the taxpayer was a large dealer in foreign securities. On December 29, 1941, it transferred a block of these securities, which it had held in inventory, to an investment ac-

count. This block and other subsequent purchases were segregated both on the books and physically and were treated in a manner substantially different from the way the inventory securities were handled. The transferred securities were later sold at a profit which was determined after using as cost their value on the date they were shifted from inventory. The unanimous court held that the profits were properly treated as capital gain. Citing the *Van Tuyl* case the Court states:

> "Certainly it cannot be argued that securities once acquired for resale to customers must forever retain their dealer status when in fact there has been a conversion of those securities from a dealer to an investment account."

The crucial fact is the purpose for which the securities were held prior to their sale. The detailed steps taken to segregate the investment from the inventory securities established their investment character.

On July 6, 1949, the Tax Court decided the case of *Nelson A. Farry v. Commissioner,* 13 T. C. No. 3. In this case the taxpayer was simultaneously engaged in two types of real estate transactions. He was active in the sale of houses and lots in subdivisions he had developed and also held large numbers of low-grade buildings for the rental income they produced. In 1944 and 1945, as a result of the rent freeze and the increased demand for housing, he decided to sell his rental properties. He sold 19 in 1944 and 27 in 1945. Most of them had been held for over a year and some for as long as 11 years.

The Commissioner contended that the profits from the sale of the rental profits were taxable as ordinary income, contending that petitioner was holding the rental properties primarily for sale to customers in the ordinary course of his trade or business. The Tax Court held that the profits had been properly returned as capital gain, that they had been bought and held primarily for investments and not for sale to customers in the ordinary course of business. The fact that the taxpayer was also a dealer in real estate was immaterial. The Court, stating that if petitioner was holding the properties primarily for sale to customers they were not capital assets, said:

> "However, it seems to us that petitioner has proved by overwhelming evidence that he purchased and held these properties primarily for investment purposes. The fact that in the taxable years he received satisfactory offers for some of them and sold them does not establish that he was holding them 'primarily for sale to customers in the ordinary course of his trade or business.' The evidence shows that he was holding them for investment purposes and not for sale as a dealer in real estate."

If this Court should be of the opinion that the taxpayer was in the business of holding real estate for rental purposes, nevertheless, under Section 117(j) of the Internal Revenue Code, the profits from the sale of such properties are taxable as capital gains unless the properties are held primarily for sale to customers in the ordinary course of trade or business. (See *Nelson A. Farry, Inc.,* 13 T. C. 3; *Solomon Wright, Jr. v. Commissioner,* 9 T. C. 173, Acq. by Commissioner, 942 to C. B. 5; *Elgin Building Corporation,* T. C. M. (C. C. H. Decision T. C., Memorandum of Decisions 16831).)

III.

The Tax Court's Conclusion of Law Is Inconsistent With Its Findings of Fact Because the Findings Properly Made Compel the Conclusion That the Properties in Question Were Capital Assets.

Had the Tax Court made the Finding which, it is submitted, is the only Finding it could make on the uncontradicted evidence its Conclusion of Law under Section 117 of the Code had to be that the profit from the sale of these properties was taxable at capital gain rates as reported by petitioners.

In its Opinion, as distinguished from its Findings of Fact, the Tax Court gave its reasons justifying its Conclusion that the two properties sold in 1942 and the eight properties sold in 1943 were not taxable as capital assets.

Its Conclusion can only be reached by the application of a Rule of Law to the facts as found by drawing an inference from such facts to reach an ultimate Conclusion of Fact that said properties were not held for investment but were held primarily for sale. There is no fact found which compels the Finding that these properties were held primarily for sale to customers in the taxpayer's trade or business.

The factors relied upon by the Tax Court are the frequency and continuity of sales. This cannot apply to the sales in 1942 when there were only two sales by petitioners of rental properties each of which had been held for several years and one sale by Petitioner Helen Field of rental property owned by her. Research does not disclose any Rule of Law which if applied to these facts requires the Tax Court Conclusion, and in the face of uncontra-

dicted testimony to the contrary neither of these factors give rise to a justifiable inference that these properties were held primarily for sale. These factors are significant only in so far as they bear upon the factual issue of the intention of petitioners, namely, did they hold these properties for investment or for resale?

There are other factors in this case which bear on the question of intention. It is not disputed that all of the properties in question were purchased as investment and for rental income—in fact, the Tax Court finds substantially that this is true. They were all purchased with small down payments and the balance on mortgages or trust deeds, the amounts of which were from time to time reduced; these properties were carried on petitioner's books as investments; they were not advertised for sale and none of the petitioner's employees had anything to do with their management or sale. They were sold only when petitioner had an opportunity to buy larger rental properties and needed cash for that purpose, or when investment properties were available which were better than those they owned. There is no fact proved which is inconsistent with petitioner's uncontradicted testimony that these properties were held for investment and rental income and not primarily for sale; every fact proved is consistent with that testimony and there is no valid legal reason why the Tax Court should not have accepted it. Petitioner contends that as a matter of law, it was error to refuse to accept that testimony and make a Finding based upon it. The Tax Court, on the undisputed evidence, should have found that the properties in question were held as investments and for rental income, and that therefore the profit on their sale was taxable as capital gain.

IV.

Should This Court Be of the Opinion That the Tax Court Drew the Ultimate Inference Which Supports Its Decision, It Nevertheless Remains Free to Draw Its Own Ultimate Inference.

The scope of review of decisions of the Tax Court by the Courts of Appeal is no longer subject to the restrictions imposed by *Dobson v. Commissioner,* 320 U. S. 489. See Section 1141(a), Internal Revenue Code, which became effective September 1, 1948. The Courts of Appeal now have jurisdiction to review decisions of the Tax Court, "in the same manner and to the same extent as decisions of the District Court actions tried without a jury."

While it has long been established practice of the Circuit Courts not to set aside a Finding of Fact of the District Court unless clearly wrong or unsupported by substantial evidence this rule is restricted to situations where the subjects of review are evidentiary or primary facts which the Court has found upon hearing witnesses who appeared before it so that it was in a better position than the Reviewing Court to judge their credibility as opposed to situations in which the question is one of drawing inferences from the facts found by the Trial Court. In the latter situation the Reviewing Court is in as good a position to draw its own inferences or conclusions from the evidentiary facts as found by the Trial Court as is the Trial Court itself, since there is no question of credibility of witnesses involved. See *Kuhn v. Princess Lida of Thurn & Taxis,* 119 F. 2d 704, a leading case stating this principle. In this case the plaintiff sued for reasonable attorney's fees for professional services rendered to defendant in connection with a tax controversy before the

Tax Court. The District Court found that $8,500.00 was a reasonable attorney's fee considering all the facts of the case, including difficulty of legal problems involved, amount of time spent in litigation and other matters. The Court reversed and remanded with direction to enter judgment for $2,500.00 in favor of the plaintiff. The Court said that the Conclusion as to the reasonable value of the service was an ultimate fact and so subject to a complete review on appeal. The Court said:

> "The appellee reminds us that we are not at liberty to disturb findings of fact made by the trial court unless they are unsupported by evidence or are otherwise clearly erroneous. Rule 52(a), 28 U. S. C. A. following section 723c. The reason for the rule rests in large part upon the fact that the trial judge who hears the witnesses testify and observes their demeanor upon the stand is better qualified to appraise the credibility of their testimony and to resolve the conflicts therein. So long, therefore, as a finding of fact is supported by evidence, and is not clearly erroneous, it is to be accepted on appeal as verity.
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> The rule does not operate, however, to entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings. And so, while accepting the facts competently found by the trial court as correct, an appellate court remains free to draw the ultimate inferences and conclusions which, in its opinion, the findings reasonable induce. Such was the law prior to the promulgation of the Rules of Civil Procedure. *Brown v. United States,* 3 Cir., 95 F. 2d 487, 490; *Dunn v. Trefry,* 1 Cir., 260 F. 147, 148. The new Rules have worked no change in this regard, or with respect to the ultimate conclusions in jury-waived cases in particular. *Cf. Aetna Life Insurance Co. v. Kepler,* 8 Cir., 116 F.

2d 1, 5. See also 3 Moore, Federal Practice, p. 3115, *et seq.* and notes of the Advisory Committee on Rule 52(a). The sufficiency of the evidence to sustain a trial court's conclusion or finding of an ultimate fact remains appropriate matter for an appellate court's consideration. *State Farm Mutual Automobile Insurance Co. v. Bonacci et al.,* 8 Cir., 111 F. 2d 412, 415. Where the evidentiary facts are not in conflict or dispute, the conclusions to be drawn therefrom are for the appellate court upon review of the trial court's action. *Cf. United States v. South Georgia Railway Co.,* 5 Cir., 107 F. 2d 3, and *United States v. Mitchell,* 8 Cir., 104 F. 2d 343, 346. An incorrect conclusion by a trial court qualifies as a 'clearly erroneous' finding, for the correction whereof on appeal Rule 52(a) specifically provides.

In the instant case, the trial court's conclusion as to what constituted reasonable compensation for the plaintiff's services rested upon no direct testimony of witnesses. Not only were the respective witnesses far apart in their estimates as to the value of the plaintiff's services but none of them approximated the amount arrived at by the trial judge. The plaintiff himself testified to $25,000 (the amount for which he sought recovery) as the value of his time and effort. And, of the two experts whom he produced, one testified to $25,000 and the other to $30,000. On the other hand, one of the defendant's experts fixed the value of the services at $1,500 while the other gave $2,000 as his estimate, the latter sum also covering some services contemporaneously performed by the plaintiff for defendant's sons with respect to assessments for tax on income received by them from the same source as the defendant's."

This Court recently reversed the Tax Court by drawing its own ultimate inference from the undisputed facts,

which inference was contrary to the inference drawn by the Tax Court. In *Wilshire and Western Sandwiches, Inc. v. Commissioner,* 175 F. 2d 718, the facts in that case were that the taxpayer was incorporated for the purpose of engaging in the restaurant business and the original intention of its four incorporators, which later became its stockholders, was to finance the construction of the restaurant out of advances made by them in the amount of $30,000, half of which was to be capital stock contribution and half a loan. The Tax Court found the parties intended to make advances for stock and loans on an equal basis, yet it found from inferences drawn by it from other facts that the original intent was nullified.

In holding that the advances were converted into investments so that interest was not deductible, the Tax Court emphasized that the advances were made at the same time as the capital investments, in the same proportions and for the same purpose—to provide working capital; that the incorporators varied the ratio between loans and investments from the original plan; though the first advances were made in May, 1941, the notes given in the corporation were not recorded until April or May, 1942, and they were not secured; also interest was not accrued on its books until 1943 and was not paid until December 1, 1943. The Tax Court emphasized that the initial book entries did not treat the advances as loans; that the payments of interest and principal were made from the profits of petitioner as the incorporators expected. This Court reversed that decision, finding that the chief factor was the stockholders' intent at the time of entering the transaction that it be a loan. This Court said:

> "Respondent asserts that the transactions under consideration here have few of the characteristics of

> the people dealing at arm's length. Whatever view may be taken as to the number of those characteristics, the controlling fact remains that those which appeared are the essentials of a bona fide transaction. In reaching this conclusion we think we are dealing with substance and reality and not mere form, a requirement in the field of taxation."

As applied to the case at bar the ultimate inference is, the inference as to whether the properties in question sold in 1942 and 1943 were held by petitioners for investment and rental income, or whether they were held primarily for sale to customers in the ordinary course of their trade or business. This Court is as competent as the Tax Court to draw this inference from the relevant facts. This Court, sitting as a court of review, is free to determine the intention of the parties from the primary facts competently found by the Tax Court without regard to whether or not there is support in the record for the inference drawn by the Tax Court. However, it is submitted that only one reasonable inference can be drawn from the undisputed evidence, and that is, that the properties sold by petitioners in 1942 and 1943 were held by them for investment and rental income and not primarily for sale to customers, and that they are, therefore, entitled to capital gain benefits.

It was the intention of Congress in enacting Amendment to the Internal Revenue Code, Section 1141(a)m that reviewing courts should have the power to draw their own conclusions as to ultimate facts. The Senate Committee on the Judiciary stated the language approved had the effect of repealing the rule of *Dobson v. Commissioner, supra,*

> ". . . to the effect that decisions of the Tax Court on questions of fact, including questions of account-

ing and ultimate conclusions of fact, are not reviewable if supported by any evidence in the record."

Senate Committee on Judiciary, 80th Congress, Second Session, Report No. 1559, p. 131.

Congress felt that courts of review should be free to reverse decisions of the Tax Court on questions of ultimate fact without reference to whether or not the conclusions of the Tax Court had support in the record. This insures that the most reasonable of conflicting inferences will be chosen and justice done.

Conclusion.

Only one reasonable conclusion can be reached from the facts in this case and that is, that the real properties sold by petitioners in 1942 and 1943 were held by them as investments and for rental income and that they were not held primarily for sale to customers in the ordinary course of taxpayers' trade or business. The profits on their sale, therefore, is taxable at capital gain rates and not as ordinary income.

The decisions of the Tax Courts should, therefore, be reversed and judgment entered in favor of the petitioners, holding the profits on the sales of the properties in question were correctly reported as profits from the sale of Capital Assets, and not ordinary income.

Respectfully submitted,

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